

**Updated Informative Digest for the State Board of Equalization's
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 1705, *Relief From Liability***

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, on December 17, 2013. During the public hearing, the Board was informed that Board staff made a minor error in the text of the proposed amendments to Regulation 1705 published on the Board's website and made available to the public during the notice and comment period. Specifically, staff inadvertently failed to show that, during the August 13, 2013, Business Taxes Committee (BTC) meeting, the Board approved amendments replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation, as shown in the agenda for the August 13, 2013, BTC meeting attached to Formal Issue Paper 13-006 and exhibit 2 to Formal Issue Paper 13-006.

As a result, during the December 17, 2013, public hearing, the Board authorized staff to make the text of the proposed amendments to Regulation 1705 consistent with the text of the proposed amendments to Regulation 1705 that the Board approved on August 13, 2013, by replacing the phrase "that person" with the phrase "those persons" at the end of the second paragraph in subdivision (a) of the regulation. The Board also directed staff to make the text of the proposed amendments to Regulation 1705, with the substantially related change clearly indicated, available to the public for at least 15 days prior to adoption, as required by Government Code section 11346.8, subdivision (c).

On December 24, 2013, the Board made the revised text of the proposed amendments to Regulation 1705, with the change discussed above clearly indicated, available to the interested parties and posted the revised text on its website at www.boe.c.a.gov. Also, during the Board's January 16, 2014, meeting, the Board unanimously voted to adopt the proposed amendments to Regulation 1705 with the change discussed above.

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on December 17, 2013, or the Board meeting on January 16, 2014, to comment on the proposed regulatory action. There have not been any changes to the applicable laws or the effects of, the objectives of, and anticipated benefits from the adoption of the proposed amendments to Regulation 1705 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulatory action provides:

Current Law

RTC section 6005 currently defines the term "person" for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes "any individual, firm, partnership, joint venture,

limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.”

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person’s failure to make a timely return or payment is due to the person’s reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief). Currently, under RTC section 6596, subdivision (b), a person’s failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board’s written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board’s earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that “[o]nly the person making the written request shall be entitled to rely on the [B]oard’s written advice to that person.”

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative’s written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board’s written response to the representative for RTC section 6596 relief;

- Regulation 1705, subdivision (c) currently applies to audits, states that the “[p]resentation of [a] person’s books and records for examination by an auditor shall be deemed to be a written request for the audit report,” and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that “[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person.”

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person’s representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705,

subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did no[t] determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language

and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and

- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.